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BEFORE THE ARIZONA CORPORATION COMMISSION

COMMISSIONERS

JEFF HATCH-MILLER, Chairman
WILLIAM A. MUNDELL
MIKE GLEASON
KRISTIN K. MAYES
GARY PIERCE

IN THE MATTER OF THE APPLICATION OF GRAHAM COUNTY UTILITIES, INC. FOR APPROVAL OF LONG TERM DEBT.

DOCKET NO. W-02527A-06-0505

DECISION NO. 69245

ORDER

Open Meeting
January 16 and 17, 2007
Phoenix, Arizona

BY THE COMMISSION:

Having considered the entire record herein and being fully advised in the premises, the Arizona Corporation Commission ("Commission") finds, concludes, and orders that:

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FINDINGS OF FACT

1. On August 8, 2006, Graham County Utilities, Inc. ("Graham" or "Cooperative") filed an application with the Commission requesting authorization for its water division to incur debt with the United States Department of Agriculture ("USDA") Rural Development in an amount not to exceed $1,100,000. USDA Rural Development will also provide a grant not to exceed $969,620.

2. On August 8, 2006, Graham filed an affidavit of publication verifying that it had caused notice of its finance application to be published. Because the first notice did not contain the amount of the financing request, on September 13, 2006, the Cooperative published a second, corrected, notice in the *Eastern Arizona Courier*, a newspaper published in the City of Safford, Graham County. Graham filed the affidavit of publication for the second notice on September 21, 2006.

3. On November 6, 2006, the Commission's Utilities Division Staff ("Staff") filed their

Staff Report recommending approval of the application with conditions.

4. Graham is a nonprofit member-owned Arizona corporation that provides water and natural gas distribution service in small communities in and around Thatcher, Safford, and Pima in Graham County, Arizona.

5. Graham's water division rates were approved in Decision No. 61056 (August 6, 1998).

6. As of September 30, 2005, Graham provided service to approximately 1,100 water customers and 4,900 gas customers.

7. The purpose of the financing request is to: (1) finance the construction of water treatment projects to comply with the United States Environmental Protection Agency's ("EPA") drinking water standard for arsenic; (2) develop a new water source to meet the demand of the Cooperative's current customers; and (3) refinance $130,547 in long-term debt.

8. The proposed loan would have a term of 40 years and an interest rate of 4.375 percent per annum. The loan would have an interest-only payment due 12 months from the day of closing. Thereafter, monthly payments would be approximately $5,000.

9. Graham hired an engineering firm, Fluid Solutions, to perform a study to analyze the conditions and alternative solutions to resolve the Cooperative's water quantity and quality issues. The Cooperative is currently experiencing difficulty in meeting water demand and the EPA arsenic standard of 10 ppb. The engineering report indicates that Graham's 10 operating wells have arsenic levels that range from 3 μg/l to 50 μg/l, with an aggregate arsenic concentration of 15.69 μg/l.[1] The engineering firm recommends as the most cost effective solution a blending plan that includes the addition of six new wells, a pilot well and a 500,000 gallon water storage tank. The total estimated cost for the recommended wells and storage tank additions was $1,951,620, which includes a 10 percent contingency fee and future engineering costs.

10. Engineering Staff examined the construction plans and estimated costs for Graham's water treatment project and found them to be reasonable and appropriate. Staff states, however, that approval of this financing application does not imply any particular future treatment for rate base.

[1] U.S. Environmental Protection Agency requirements that went into effect January 23, 2006 require that arsenic levels in potable water systems be at or below 10 μg/l.

Staff states that no "used and useful" determination of the proposed plant was made, and no conclusions should be inferred for rate making or rate base purposes.

11. Staff performed a financial analysis based on Graham's audited financial statements dated September 30, 2005. As of September 30, 2005, Graham's capital structure consisted of 5.77 percent short-term debt, 89.36 percent long-term debt, and 4.87 percent equity. Staff's analysis shows that if Graham draws down the entire $1.1 million loan, which includes the refinancing of a $130,548 loan, its capital structure would consist of 4.62 percent short-term debt, 91.65 percent long-term debt and 3.73 percent equity.

12. Staff recognizes that the Cooperative's proposed loan would result in a capital structure that is more leveraged than preferable. Staff prefers a cooperative such as Graham to have at least 30 percent equity. Staff believes, however, that there are no better options for Graham to finance the construction of the arsenic removal plant. Staff notes that non-compliance may result in delivery of unsafe water or other negative operational and financial consequences for the Cooperative and its members.

13. Staff believes that due to Graham's highly leveraged capital structure, it is appropriate for the Commission to condition any authorization for debt issuance on the Cooperative adopting an equity accumulation plan. Staff sets forth the following components of its recommended plan:

a. Establish a base members' equity position by using the Cooperative's total members' equity at September 30, 2005, of $154,258.

b. Establish an objective to increase members' equity over the base position by no less than two percent of all cumulative revenues recorded subsequent to September 30, 2005, as measured at the end of each fiscal year, until members' equity represents at least 30 percent of total capital; and thereafter, to maintain at a minimum members' equity at 30 percent of total capital.

c. Require filing a rate application no later than June 30th of the year subsequent to any fiscal year in which the equity goal is not achieved. Staff believes that a waiver[2] for

[2] Staff states that waiver requests should be made by December 31st and memorialized with a memorandum to Docket Control noting the request. Support for a waiver request may be conveyed in any suitable form and include any relevant information; however, Staff states that Graham should expect at a minimum to provide Staff with financial projections

the current year only may be granted if Graham can demonstrate to Staff's satisfaction that it is likely to comply with the cumulative members' equity objective within 24 months without any rate adjustment. A rate filing should be filed by any and all division(s) whose net margin(s) is (are) less than two percent of operating revenue in the prior fiscal year.

d. Require filing of an annual report by April 15th with Docket Control, as a compliance item until such time that members' equity equals no less than 30 percent of total capital. Illustrative examples of the type and form of information to be filed are shown on Exhibit 1 of the Staff Report. The report should include the following:

   i. Annual revenues for each fiscal year ending after September 30, 2005;
   ii. Cumulative revenues recorded subsequent to September 30, 2005;
   iii. The members' base equity position at September 30, 2005 (i.e. $154,258);
   iv. The members' equity position at the end of each fiscal year after September 30, 2005; and
   v. A declaration of the Cooperative's compliance or non-compliance with the two percent equity growth requirement discussed in item no. b.

14. The Times Interest Earned Ratio ("TIER") represents the number of times earnings cover interest expense on long-term debt. A TIER greater than 1.0 means that operating income is greater than interest expense. A TIER less than 1.0 is not sustainable in the long term but does not mean that debt obligations cannot be met in the short term.

15. Debt service coverage ratio ("DSC") represents the number of times internally generated cash will cover required principal and interest payments on long-term debt. A DSC greater than 1.0 indicates that operating cash flow is sufficient to cover debt obligations. A DSC less than 1.0 means that debt service obligations cannot be met by cash generated from operations and that another source of funds is needed to avoid default.

16. Based on the 2005 financial statements, Staff's analysis shows that Graham's TIER

(with all critical assumptions identified) that demonstrate how the equity objective will be met. Staff recommends that the waiver be denied unless Staff files a memorandum with Docket Control by March 1st accepting the waiver request. Staff states a waiver should be applicable to the current year only and not be granted in consecutive years.

and DSC without the proposed loan are 1.56 and 1.34, respectively. Staff states that fully drawing the proposed $1,100,000 loan and refinancing the existing $130,548 loan, reduces the TIER and DSC to 1.27 and 1.18, respectively. Staff states that its pro forma analysis shows that Graham would have adequate cash flow to meet all obligations including the proposed debt.

17. Staff concludes that the project the Cooperative proposes to construct and the refinancing of the $130,547 in long-term debt is reasonable and appropriate. Staff further concludes that the proposed financing is within Graham's powers as an corporation, is compatible with the public interest and would not impair its ability to perform as a public service corporation. Staff states that the proposed loan would be consistent with sound financial practices if the Cooperative has a plan that is satisfactory to Staff to build equity to 30 percent of total capital.

18. Staff recommends approval of the Cooperative's application for authority to issue debt to USDA Rural Development not to exceed $1,100,000 subject to the condition that it adopt the equity accumulation plan set forth in Findings of Fact No. 13.

19. Staff further recommends that the Commission should authorize Graham to engage in any transactions and to execute any documents necessary to effectuate the authorizations granted herein and that Graham file copies of the executed security documents with Docket Control, as a Compliance item in this docket, within 60 days of the execution of any transactions.

20. The Staff Report indicates that the Cooperative's water systems are currently in compliance with Arizona Department of Environmental Quality ("ADEQ") requirements and delivering water that meets water quality standards required by Arizona Administrative Code, Title 18, Chapter 4.

21. The Commission's Utilities Division Compliance Section shows no outstanding compliance issues for the Cooperative.

22. A Curtailment Plan Tariff ("CPT") is an effective tool to allow a water company to manage its resources during periods of shortages due to pump breakdowns, droughts, or other unfortunate events. Since the Cooperative currently does not yet have a CPT, Staff believes that this application provides an opportune time for it to prepare and file a CPT. Staff recommends that the Cooperative file a CPT with Docket Control, as a compliance item this docket, within 45 days after

the effective date of the Decision in this matter for the review and certification of Staff. Staff further recommends that the tariff should generally conform to the sample tariff found on the Commission's website at www.cc.state.az.us/utility/forms/curtailment-std.pdf. Staff states it recognizes that the Cooperative may need to make minor modifications to the sample tariff according to its specific management, operational and design requirements as necessary and appropriate.

CONCLUSIONS OF LAW

1. Graham is a public service corporation within the meaning of Article XV of the Arizona Constitution and A.R.S. §§ 40-301, 40-302, and 40-303.

2. The Commission has jurisdiction over Graham and of the subject matter of the application.

3. Notice of the application was given in accordance with the law.

4. The recommendations set forth in Findings of Fact Nos. 13, 18, 19 and 22 are reasonable and should be adopted.

5. The financing, as approved herein, is for lawful purposes within Graham's corporate powers, is compatible with the public interest, with sound financial practices, and with the proper performance by Graham of service as a public service corporation, and will not impair Graham's ability to perform the service.

6. The financing approved herein is for the purposes stated in the application, is reasonably necessary for those purposes, and such purposes are not, wholly or in part, reasonably chargeable to operating expenses or to income.

ORDER

IT IS THEREFORE ORDERED that Graham County Utilities, Inc. is hereby authorized to borrow up to $1,100,000 from the United States Department of Agriculture Rural Development with a term of 40 years and an annual interest rate of 4.375 percent subject to the conditions set forth herein below.

IT IS FURTHER ORDERED that such finance authority shall be expressly contingent upon Graham County Utilities, Inc.'s adoption of an equity accumulation plan as set forth in Findings of Fact No. 13.

IT IS FURTHER ORDERED that such finance authority shall be expressly contingent upon Graham County Utilities, Inc.'s use of the proceeds for the purposes stated in its application and approved herein.

IT IS FURTHER ORDERED that Graham County Utilities, Inc. is authorized to execute any documents necessary to effectuate the authorizations granted.

IT IS FURTHER ORDERED that Graham County Utilities, Inc. shall file with Docket Control, as a compliance item in this docket, copies of all executed financing documents within 60 days after the date of execution.

IT IS FURTHER ORDERED that Graham County Utilities, Inc. shall file with Docket Control, as a compliance item in this docket, within 45 days after the effective date of this Decision, a Curtailment Plan Tariff that substantially complies with the sample tariff found on the Commission's website, for the review and certification of Staff.

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IT IS FURTHER ORDERED that approval of the financing set forth hereinabove does not constitute or imply approval or disapproval by the Commission of any particular expenditure of the proceeds derived thereby for purposes of establishing just and reasonable rates.

IT IS FURTHER ORDERED that this Decision shall become effective immediately.

BY ORDER OF THE ARIZONA CORPORATION COMMISSION.

CHAIRMAN

COMMISSIONER

COMMISSIONER

COMMISSIONER

COMMISSIONER

IN WITNESS WHEREOF, I, BRIAN C. McNEIL, Executive Director of the Arizona Corporation Commission, have hereunto set my hand and caused the official seal of the Commission to be affixed at the Capitol, in the City of Phoenix, this 14th day of Jan., 2007.

BRIAN C. McNEIL
EXECUTIVE DIRECTOR

DISSENT ______________

DISSENT ______________

JR:mlj

SERVICE LIST FOR: GRAHAM COUNTY UTILITIES, INC.

DOCKET NO. W-02527A-06-0505

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